



## IX. Tax Information and Legal Issues

### Tax Information

#### Income Tax Withholding

Federal and California statutes require income tax withholding on distributions from pension plans, annuities, and deferred compensation plans. Income tax will be withheld from the taxable portion of your allowance unless you take action *not* to have taxes withheld. If you do *not* have taxes withheld, or if you do not have enough withheld, you may need to make estimated tax payments. Generally, your withholding or estimated tax payments, or the total of both, must cover at least 90 percent of your total tax liability for the current year. Failure to meet the 90 percent limit could subject you to penalties.

A portion may not be taxable if you made post-tax contributions to STRS during your career. STRS uses the Simplified General Rule established by the Internal Revenue Service (IRS) to determine the taxable portion of your allowance. (You may use any acceptable method when reporting to the IRS.) The Simplified General Rule is explained in detail in *Pension and Annuity Income*, IRS publication 575, available from the IRS, or *Pension and Annuity Guidelines*, FTB publication 1005, from the state Franchise Tax Board, or *Notification of Income Tax Withholding*, MS 1357, from STRS.

#### Periodic Payments

Unless you tell STRS otherwise, STRS will withhold tax on periodic payments (a payment that is received in installments at regular intervals) as if you were married and claiming three dependents.

#### Non-Periodic Payments

STRS withholds income tax from non-periodic payments (such as a lump-sum death payment or the allowance accrued and unpaid on the date of death of a STRS benefit recipient) at a flat rate of 20 percent for federal and six percent for state withholding. Your beneficiary can elect to have no tax withheld from a non-periodic payment unless he or she resides outside of the United States or its possessions, in which case, tax must be withheld on a non-periodic payment.

#### Income Tax Withholding Preference Certificate (AD-0908)

If you wish to request a change to your income tax withholding status, you must prepare an *Income Tax Withholding Preference Certificate*, AD-0908.

The form must be received by STRS no later than the first day of the month preceding the month you wish the instructions to take effect. You may obtain an AD-0908 from STRS by calling the STRS automated telephone system at 1-800-228-5453.

#### Lump-Sum Distributions

If you receive a lump-sum distribution, including a refund of your contributions, you should be aware that the Internal Revenue Code (IRC) provides several complex rules regarding the taxation and penalties of lump-sum distributions. You may be eligible to avoid current taxation on the taxable amount of the distribution by rolling over that amount into another qualified employer retirement plan or Individual Retirement Arrangement (IRA).



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To take advantage of these provisions, the distribution must be made by a trustee-to-trustee transfer. If you request a rollover distribution, additional information will be provided. Contact STRS Public Service at 1-800-228-5453 or (916) 229-3870 for information regarding rollovers.

### Source Tax

STRS must withhold state income tax on all monthly (periodic) payments unless the payee has filed with STRS an *Income Tax Withholding Preference Certificate*, AD 0908, requesting that taxes not be withheld and stating the payee is not a resident of California. Benefit recipients who live outside California will not have state tax withheld *unless requested by filing* an AD 0908.

The change is the result of recent federal legislation that repealed the right of individual states to tax retirement payments of recipients who are *not* residents of the state from which they are receiving the benefits (source tax). Consequently, if you are *not* a resident of California, you may not be subject to California state tax. However, you should be aware that your current tax liability in the state in which you reside could increase as a result of the change in law.

STRS recommends that you consult a qualified tax professional for specific tax advice. You should contact the Internal Revenue Service, the California State Franchise Tax Board, or a qualified tax adviser for information relevant to your individual situation. Call STRS Teletalk at 1-800-228-5453 and request message #650 or you may use the automated telephone system to obtain a copy of the STRS brochure, *Benefit Tax Information*, AD 202.



### Internal Revenue Code Section 415

Section 415 of the IRC imposes two limits on benefits that can be paid by a state or local government defined benefit retirement system such as STRS. Benefits are limited to the lesser of 100 percent of the participant's average annual compensation for the highest three years of taxable compensation, or an absolute dollar cap indexed for inflation.

Congress recently passed Pension Simplification legislation as part of the Small Business Job Protection Act of 1996 (SBJPA). This legislation provided some relief from the IRC section 415 limits for government pension plans which must be implemented by 1999. STRS is currently analyzing the provisions of the SBIPA and will recommend appropriate changes in the near future.

Currently, very few STRS members have been impacted, or are likely to be impacted, by the limits of Section 415. STRS will notify you, upon receipt of your application for retirement, if the IRC Section 415 limits impact your benefit.

### Legal Issues

#### Subrogation

When a third party causes the injury or death of a STRS member before retirement, and the member or family pursues civil litigation, STRS must be informed. STRS has a right to participate in the action to recover the expenses and legal costs the injury or death generated. The process which permits this participation is called subrogation.

#### Power of Attorney

STRS members can arrange for management of their assets, should they become incapacitated, through the use of a Durable Power of Attorney. STRS can provide you with some of the necessary forms.

When a STRS benefit recipient becomes incapacitated and can no longer manage his or her financial affairs, STRS must determine who has the legal authority to act on the recipient's behalf regarding the recipient's STRS account and benefits. That authority

could extend to changing the recipient's address, instituting or changing direct deposit authorizations, and changing tax withholding preferences.

A Durable Power of Attorney is the most common method used by a benefit recipient to delegate authority to act for the recipient. This document permits a benefit recipient to act as a principal and appoint an agent. The document also identifies the extent of authority granted to the agent.

A Durable Power of Attorney can be drafted by an attorney or purchased as a commercially available fill-in-the-blank form. STRS has a *Special Power of Attorney*, MS 1307, form available that may be used by a principal. The STRS MS 1307 enables your named agent to handle all matters pertaining to a STRS account, unless barred by law.

In addition, STRS requires an agent to execute an affidavit affirming the agent's authority under the Durable Power of Attorney. For an agent's convenience, STRS has a *Declaration of Attorney in Fact*, MS 1432, that can be completed by the agent each time the agent makes a request.

If you wish to obtain a *Special Power of Attorney*, MS 1307, or a *Declaration of Attorney in Fact*, MS 1432, call STRS automated telephone system at 1-800-228-5453 or (916) 229-3870.

### **Dissolution or Annulment and STRS Benefits**

A publication for members who have questions about the effect of dissolution or annulment of marriage on STRS benefits will soon be available. At the present time, questions about dissolution of marriage can be directed to STRS Legal Office, (916) 229-3768 or (916) 229-3769.



